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MAY REVISION GOVERNOR'S BUDGET 1987-1988

GEORGE DEUKMEJIAN
GOVERNOR
STATE OF CALIFORNIA

DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

May 19, 1987

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Honorable William Campbell, Chairperson
Joint Legislative Budget Committee

Honorable Alfred E. Alquist, Chairperson
Senate Committee on Budget and Fiscal Review

Honorable Robert Presley, Chairperson
Senate Appropriations Committee

Honorable John Vasconcellos, Chairperson
Assembly Ways and Means Committee

Gentlemen:

GENERAL FUND MAY REVISION

As indicated in my letter of May 11, this letter provides a complete update of revenues and expenditures, as well as a full accounting of the State Appropriations Limit.

I am pleased to report that this is the first budget fully implementing the provisions of Proposition 4 of 1979 (State Appropriations Limit) allowing for a rebate to taxpayers of $700 million. This is the result of continued strong performance of California's economy, which, in turn, provides greater than anticipated revenues.

REVENUES

Forecasting revenues has been more difficult than usual this year. On balance, our economic forecast now is not substantially different from that used in January. Revenues have come in far stronger, however, and the Department of Finance now expects current year General Fund revenues to be $1.7 billion above earlier projections. This phenomenal growth is due primarily to substantial increases in Personal Income and Bank and Corporation Taxes in response to the new Federal Tax Reform Act.

For those inclined toward criticism of California's revenue estimating, it should be noted that the Federal government and other states have also received income tax revenues substantially higher than estimated, indicating that this unusual growth is not peculiar to California. In fact, it seems to be a phenomenon unanticipated by all forecasters.

For the 1987-88 Budget Year, we are projecting continued growth of the General Fund to be approximately $1 billion above the January forecast. These changes in current revenues and the prediction of continued growth in our economy, provide the opportunities for the first rebate program under Proposition 4 of 1979 and for increased expenditures in key program areas.

EXPENDITURES

As indicated in our May 11, 1987 report, we have had unprecedented growth in caseload and cost of services in State programs which have required additional expenditures from the General Fund of $410 million in 1986-87 and $599 million in 1987-88.

The revenue forecast which we are providing today provides us an opportunity for improved funding in priority program areas for this Administration.

Education

Education funding for 1987-88 is now proposed at $17.8 billion from the General Fund. This represents an increase of $400 million over our letter of May 11. For the 1987-88 Fiscal Year, the Administration is proposing General Fund education expenditures of $849 million over the 1986-87 year.

- **K-12** The Administration is proposing to increase K-12 General Fund expenditures by $217 million above previously proposed levels. These increases in funding are necessary but will not be as effectively used as possible unless complemented by reforms, specifically legislative authorization for reforms such as: development of a less adversial system of collective bargaining, more focused on the interests of California students; development of accountability measures of student performance; and establishment of improved fiscal accountability measures to maximize management control and effectiveness.

- **Community Colleges** The Administration is proposing to increase General Fund expenditures for the Community Colleges by $99.5 million.

- **California State University** The Administration is proposing to increase California State University General Fund expenditures by $45.4 million above previously proposed levels.

- **University of California** The Administration is proposing to increase University of California General Fund expenditures by $40 million above previously proposed levels.

Employee Compensation

- State employees will also benefit from these new-found resources, with funding for up to 3 percent across-the-board salary increases for all civil service classes including non-faculty employees in our higher education facilities.

- Faculty salary increases will be brought up to 5.7 percent for UC and 6.9 percent for CSU. These salary increases will begin January 1, 1988.

Health and Welfare

Key health and welfare programs funded from the General Fund will be increased to ensure continuation of essential safety net health programs:

$6.7 million for implementation of Proposition 65 to fund activities including: monitoring and enforcement; scientific; technical assistance; reporting; and management and support.

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$7.0 million for AIDS to expand anonymous and confidential testing, information and education activities and pilot projects to test treatment and case management systems.

$12.5 million for rate increases for hospital contracting-disproportionate share providers.

$62.9 million for Cost-of-Living Adjustments in the following programs: Aid to Families with Dependent Children, Supplemental Security Income/State Supplementary Program, Medi-Cal (including long-term care); and In-Home Supportive Services.

We will continue to pursue and increase disengagement of programs from the State to the local level providing greater opportunities for local decision making in public health programs they administer.

STATE APPROPRIATIONS LIMIT

For the first time since enactment of Proposition 4, the State will return to taxpayers receipts in excess of the constitutional spending limit. We are proposing legislation to return the entire Proposition 4 excess of $700 million to individual income taxpayers during 1987-88. We believe that the circumstances dictate a prompt response and an equitable distribution of this rebate. Because the unusual revenue growth occurred in Personal Income Taxes, it is fair to return money to those taxpayers. In addition, the excess revenues appear to have resulted from a one-time phenomenon calling for a one-time rebate, rather than a structural change to the tax laws.

Legislation to recognize the proper allocation of responsibility for the K-12 foundation program is also required as a companion to this rebate program. Modifying the Appropriation Limit Education funding model not only is consistent with Proposition 4 but is necessary to make additional funds available for Education at all levels.

As a part of this package however, the Administration continues to rely on passage of legislation that would repeal the mandates for Unemployment Insurance payments to local governments and collective bargaining for school district employees and the funding of deferred maintenance for local school districts from the State School Building Lease Purchase Fund.

I am available to discuss this revision with you at your convenience.

Very truly yours,

JESSE R. HUFF
Director of Finance

Attachment

MAY REVISION

REVENUE AND EXPENDITURE UPDATE

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May 19, 1987

GENERAL FUND
BUDGET UPDATE
1986-87 and 1987-88
(Dollars in Millions)

	Amount	
	1986-87	1987-88
PRIOR YEAR BALANCES:	$686.3	$1,044.4
REVENUES AND TRANSFERS:		
As of January 10, 1987	$30,764.8	$31,742.0
May Revision Adjustments	1,697.6	517.7
Total Revenues and Transfers	$32,462.4	$32,259.7
TOTAL RESOURCES:	$33,148.7	$33,304.1
EXPENDITURES:		
As of January 10, 1987	$30,889.8	$31,263.6
May 11 Revision Adjustments	410.1	599.0
May 19 Revision Adjustments	104.4	209.5
Total Expenditures	$31,404.3	$32,072.1
RESERVES:		
Carryover Appropriations	$8.0	$8.0
Economic Uncertainties	1,026.4	1,034.0
Disaster Response--Operations Account	10.0	20.0
Total Reserves	$1,044.4	$1,062.0
PROPOSITION 4 SURPLUS	$700.0	$170.0

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THE ECONOMIC OUTLOOK IN BRIEF

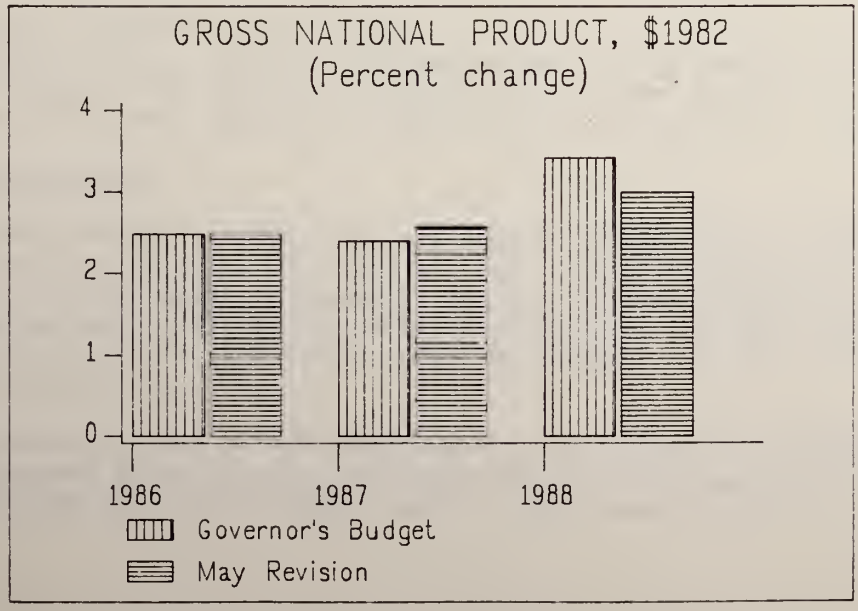
The Nation

During the time since we prepared the forecast for the Governor's Budget in January, the anticipated growth of the economy has continued. As a result, the forecast prepared for the Governor's Budget is still on track, even though individual components have been modified to reflect later data and developments.

The U.S. Commerce Department's preliminary estimate of gross national product for the first quarter of 1987 showed a 4.3 percent growth rate, reflecting a $39.1 billion increase in economic activity. The surge did not arise from improved consumer spending or fixed investment, however, but from a buildup in inventories. Consumer spending has shown the expected softness early in 1987, an easing attributable to the high level of spending for big ticket items in the second half of 1986. The outlook now revolves around two critical areas: inventories and the foreign trade balance.

Inventories saw a $59 billion swing, from a negative $28 billion in the fourth quarter last year to a positive $31 billion. Inventories therefore accounted for all of the gain in real GNP, and then some. There are indications that part of the inventory accumulation was probably involuntary, mirroring soft demand. Auto firms maintained strong production schedules even in the face of soft demand. To the extent this involuntary buildup occurred, the 4.3 percent gain reported for the first quarter is less significant than it initially appears.

The second positive element in the first quarter was the improvement in the net export figure, which went from a minus $148 billion in the fourth quarter to a minus $134 billion in the first.



In essence, inventory change and the net export balance--both of which are subject to estimating problems and large revisions--offset weakness in consumer spending, investment, and the government sector. It is likely that such cross-currents will continue for some months.

The recent rise in interest rates, for instance, has come about as a result of Federal Reserve actions to stem a resurgence in inflation, to strengthen the U.S. dollar, and to help the Treasury in its financing operations by encouraging the inflow of funds from overseas. The near-term domestic impact is expected to be a dampening of some investment activity and curtailment of spending on big ticket items.

Inflation

Concerns over potential inflation cannot be ignored, even though price rises are still moderate. During 1986, declining oil prices masked the underlying rate of inflation to a large extent. Now that oil prices have firmed and apparently stabilized, the underlying inflation rate has once again become dominant.

Prices of imports are contributing to the problem. The initial decline in the dollar had little impact on prices as margins were adjusted to absorb exchange rate movements. More recent declines in the dollar have necessitated price changes which have been substantial in some instances.

The trade deficit is expected to remain a concern throughout the year. Forecasts of sustained improvement assume that imports will be curtailed in response to rising prices, while exports gain in foreign markets due to a price advantage. The reduction in imports and rise in exports is in no way assured. There are various factors--such as the availability of commodities, consumer attitudes, political policies, cultural preferences and tariff barriers--which suggest that sustained gains will be difficult to achieve in the near term.

Inventory investment is not expected to provide the stimulus seen in the first quarter. Cutbacks are now underway in the auto industry, for instance, which should bring stocks down in the current quarter. This will effectively hold the rise in real GNP in check.

Consumer spending

Consumer spending in other areas has apparently been mixed. Sales gains reported by major retailers run from strong double-digit levels to rather anemic increases. Explanations have ranged from unusual weather conditions to over-spending toward the end of 1986. The major unknown is the impact of the new Federal tax law on consumer decisions.

With the phasing out of interest deductions on Federal tax returns, there appears to have been a pronounced shift toward home equity lines of credit. Unfortunately, specific data have not been

collected on such credit lines: they are combined with overall mortgage lending. There have been suggestions that equity financing has accelerated sharply, however, with many institutions reporting a strong surge in applications. The extent to which lines of credit are drawn down for major purchases will be a major factor in the level of consumer spending for the coming year.

Housing has continued as one of the stronger sectors, although recent run-ups in interest rates can be expected to curb demand. While the 1-1/2 percent rise in mortgage rates recently was a deterrent for some home buyers, rates still remain low in comparison with recent history. In fact, the surge in rates may actually stimulate sales to individuals concerned that rates will rise even further in coming months.

Other investment is still sluggish, reflecting the curbing of depreciation allowances, efforts to improve profit margins and an uncertain outlook.

The concern with profits is one factor underlying the slow gain in personal income. Nonessential activities are being eliminated in many firms, and wage gains held in check. Profits, as a result, appear to be strengthening more than was expected. Personal income gains, in contrast, remain low despite good gains in employment. Personal income is benefiting from higher interest rates which are starting to impact interest income. On balance, none of the components of income differ much from the Budget forecast, although the increase for 1987 is now at 4.8 percent as opposed to the 4.5 percent gain shown in the Budget.

The California Outlook

The California forecast has been raised moderately to reflect both revised California data and the new national outlook. As before, California is expected to turn in a performance which is comparable to that of the nation in some respects and substantially better in others for both 1987 and 1988.

Employment data fall in the "comparable to" category. Monthly data have suggested that year-over-year gains in the State are about equal to those for the U.S. as a whole.

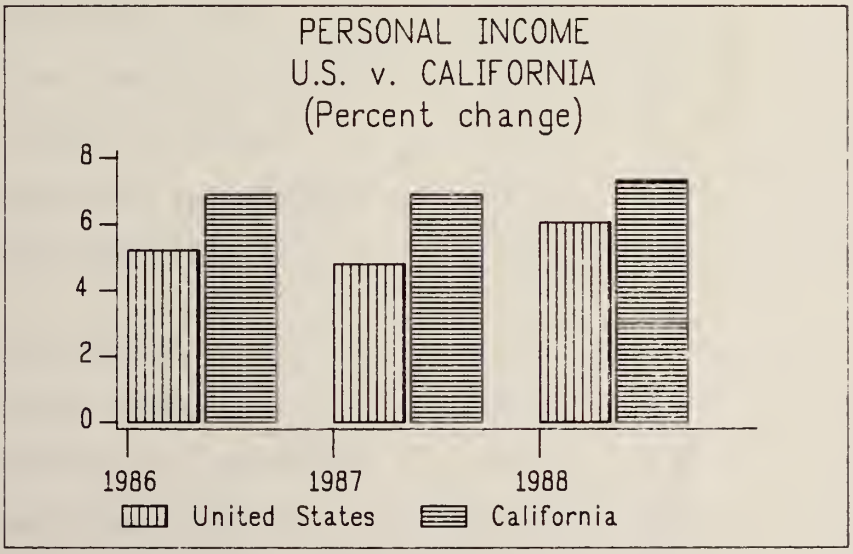
Perhaps more important, trends are quite different from one sector to another within California. Construction remains strong despite concerns that tax revision would curtail activity. Many of the jobs are undoubtedly attributable to both ongoing commercial projects and homebuilding. A slowdown in multiple housing activity has been fairly well offset by single family construction. Overall, housing authorizations for 1987 are expected to amount to 280,000, compared to the 254,000 level forecast for the Budget.

Another strong component is business services, which have been a mainstay in the employment total for some years. They are expected to see a job gain of nearly 9 percent this year.

The only soft areas appear to be durable goods manufacturing and mining. The electronics industry, for instance, is still feeling the effects of competition from imports even though it appears that a moderate improvement may be underway. The hard-hit mining industry also seems to be leveling out, and is expected to stabilize from this point on.

Personal income

The most notable aspect of the California forecast is the comparative strength in personal income. To a large extent this is due to an apparent higher average wage gain in the State than in the nation. Income is forecast up 6.8 percent in 1987 for California, with a further 7.4 percent gain in 1988. These increases are significantly above the 4.8 and 6.0 percent gains expected for the U.S. for this year and next. The 1987 gain is moderately higher than that forecast for the Budget, while the 1988 rise is only marginally better.



While a forecast of continued moderate growth appears reasonable given recent developments, there are still a number of aspects which could lead to a different forecast for 1988, if not the latter months of 1987. Economic news reports are mixed, with positive developments followed a few days later by less favorable reports. Interpretation of these in terms of an economic forecast is difficult, especially considering that data can be revised substantially in subsequent months.

Second, the current business cycle expansion has now lasted for 54 months. This is unusually long for a non-inflationary, peace-time period. Nevertheless, there are no signs of stress which would suggest a downturn is imminent. In fact, the slow pace of activity on balance over the past year and a half may well have relieved any incipient pressures, thereby insuring moderate growth for the foreseeable future.

SELECTED ECONOMIC DATA
(Percent change, except as noted)

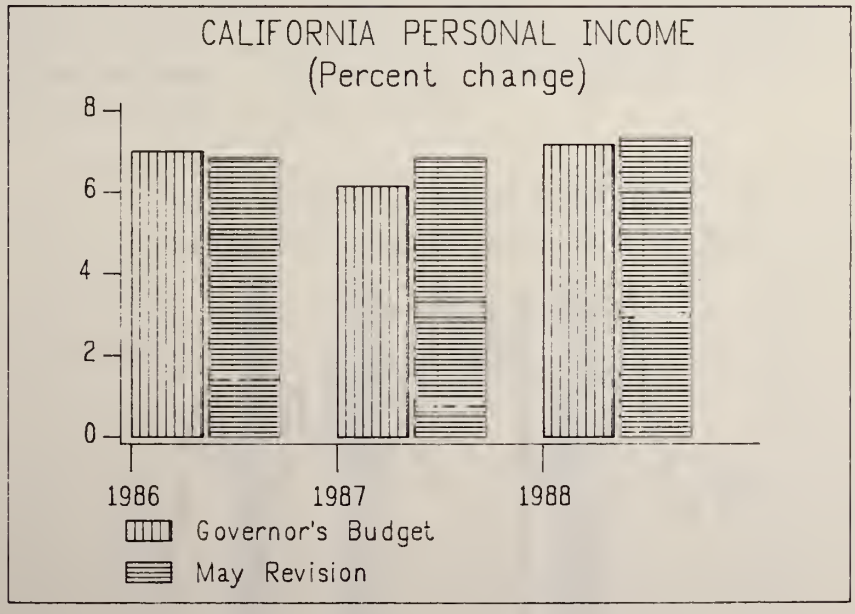
	1987		1988	
	Budget	May Revision	Budget	May Revision
National forecast				
Gross national product, 1982$	2.4	2.6	3.4	3.0
Personal income	4.5	4.8	5.8	6.0
Corporate profits	10.4	17.4	23.4	17.1
Housing starts (mn)	1.72	1.78	1.86	1.84
New car sales (mn)	10.0	9.9	10.7	10.2
Prime interest rate (%)	6.8	8.2	7.3	8.7
Consumer price index	3.1	3.7	3.6	4.0
Nonagricultural employment	2.0	2.8	2.3	3.0
Unemployment rate (%)	7.1	6.7	7.0	6.9
California outlook				
Personal income	6.1	6.8	7.2	7.4
Nonagricultural employment	2.3	3.0	2.8	2.9
Unemployment rate (%)	6.9	6.3	7.0	6.5
Housing authorizations (th)	254	280	276	270
Consumer price index	4.0	4.2	4.6	4.4

REVENUE OVERVIEW

The General Fund revenues anticipated in January have grown by nearly $1.7 billion in the current year and $1 billion in the budget year.

The increase cannot be attributed to the economy. Economic data simply do not indicate the type of boom economy necessary to support the revenue gain. The most dramatic change relates to the personal income tax. Revenues are up 22 percent for 1986-87, for example, while personal income rose only 6.8 percent. Sales tax receipts, on the other hand, are basically on track with the budget forecast and consistent with the economic outlook. Never before have we had this kind of disparity.

While it is possible that the traditional relationships between economic activity and tax collections have shifted, most of the surge in revenues seems to be due to unforseen impacts from enactment of Federal tax reform last year. To the extent that individuals and corporations anticipated Federal tax reform, revenue growth will drop in the short run. If there is a more fundamental change underway--for instance, increasing compliance with the law--revenues would continue at a higher growth rate. In this event, a new relationship would be established between the economy and tax revenues.



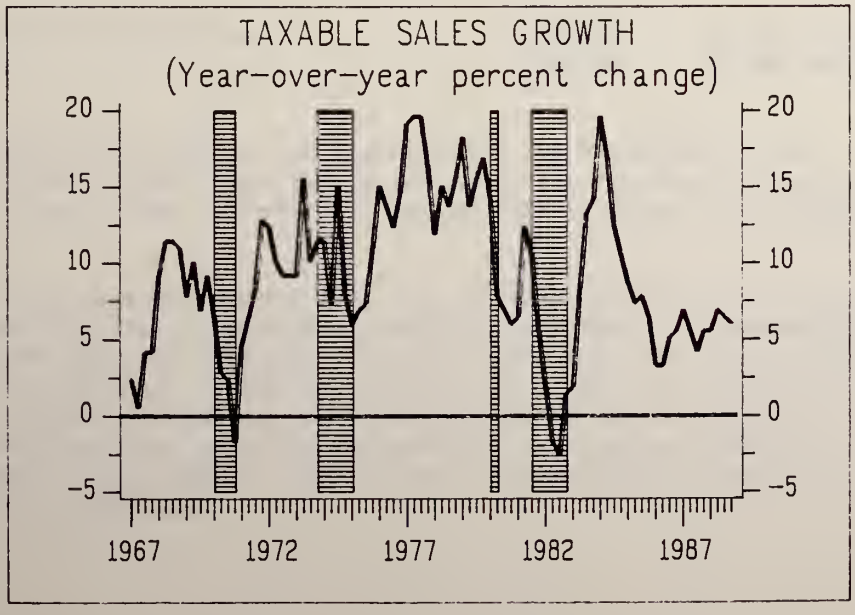
Sales and Use Tax	1986-87	$10,890 million
	1987-88	$10,583 million

Sales and use tax revenues are estimated to be up from the Budget estimate by $160 million for the current year and down from the estimate by $315 million for the budget year.

Most of this increase for the current year has already been realized and is attributable to stronger than estimated fourth quarter 1986 sales. Furniture sales and motor vehicle sales were the main contributors to this growth, increasing on a year-over-year basis for that quarter by 9.5 percent and 16.8 percent respectively.

For more than a year now, consumers have been spending a substantially smaller proportion of their disposable income on taxable goods. It is unknown if this trend is due to a shift towards a more service oriented economy or if consumers are pulling back in an effort to retire their high levels of debt. It is likely that both factors are impacting spending patterns. As in the Budget, this May revision assumes that this trend towards a smaller proportion of income being spent on taxable goods will continue through the forecast period.

The current estimate for 1987-88 revenues reflects a transfer of $45 million from the Retail Sales Tax Fund to the Transportation, Planning and Development Account consistent with the Assembly subcommittee action on this issue. This transfer was not included in the Budget estimate. Additionally $938 million is currently proposed to be transferred to local governments as a shared revenue, up $461 million from the Budget estimate. Excluding these transfers, 1987-88 revenues are estimated to be up $191 million from the Budget estimate. This revision is due entirely to the moderately stronger economic outlook.



Personal Income Tax	1986-87	$13,980 million
	1987-88	$13,710 million

Personal income tax revenues attributable to the 1986 tax year increased 22.4 percent--more than three times as fast as the growth in personal income. This tremendous surge in revenues appears to be primarily due to the impact of national tax reform. At the time the Budget forecast was prepared, the Department of Finance estimated that $350 million would be added to 1986-87 revenues by taxpayers accelerating sales of capital assets into 1986 to beat the increase in the Federal tax rates on capital gains. It now appears, based on the revenue received, that the accelerated capital gains added approximately $1 billion to revenues. Discussions with representatives from other states indicate that California's experience is not unique. Other states and the Federal government are also seeing substantial revenue gains.

The gain due to tax reform is on top of what now appears would have been an exceptionally good year for capital gains irrespective of tax law changes. Apparently, the decline in interest rates combined with the strength in the stock market to produce unusually large taxable gains. In contrast to the surge in capital gains income, the 1985 tax data recently became available and indicate a somewhat lower tax base than previously estimated for all other income.

The 1987 forecast assumes the tax attributable to income other than capital gains will continue to grow just slightly faster than personal income. On the capital gains side, the accelerations into 1986 and the higher Federal tax rate during 1987 (28%), will reduce capital gains realized over the next few years. Other behavioral changes due to Federal tax reform will moderate this loss. The net impact of tax reform in 1987-88 is now expected to be a loss of $476 million, compared with $220 million estimated in January.

Bank and Corporation Tax	1986-87	$4,660 million
	1987-88	$4,980 million

The bank and corporation tax revenues are now estimated to be significantly higher than the forecast for the Governor's Budget; up $345 million in the current year and up $305 million in the budget year.

As with the personal income tax, the greatest impact in the current year resulted from a behavioral response to Federal tax reform when unexpected year-end payments were made by corporations with pending audit assessments. Payment by a corporation does not affect the appeal process and some of the money collected may eventually be refunded when cases are finally settled. For purposes of this forecast, it was assumed that no such refunds would be made until after the budget year.

In addition to the behavioral response, the analysis of 1987 cash receipts indicates that 1986 profits were somewhat greater than estimated. Final payments in March and the first estimated payment in April were stronger than anticipated and indicate underlying profits strength. This was assumed to continue through the budget year. Also, the final statistical data for the 1985 income year was received in April and reduced some of the uncertainty inherent in the analysis of cash flow during the first part of this year.

Some underlying problems which complicate the forecasting process remain, however. In addition, the analysis of recent corporate profits has been made more difficult because there are indications that profits improved by cost cutting measures rather than by increases in price or volume. Frequent changes in national tax law over the past six years have significantly affected corporate behavior and profits even where there was not specific conformity in California tax law. This distorts historical relationships which are traditionally weighted to sales (i.e., price and volume).

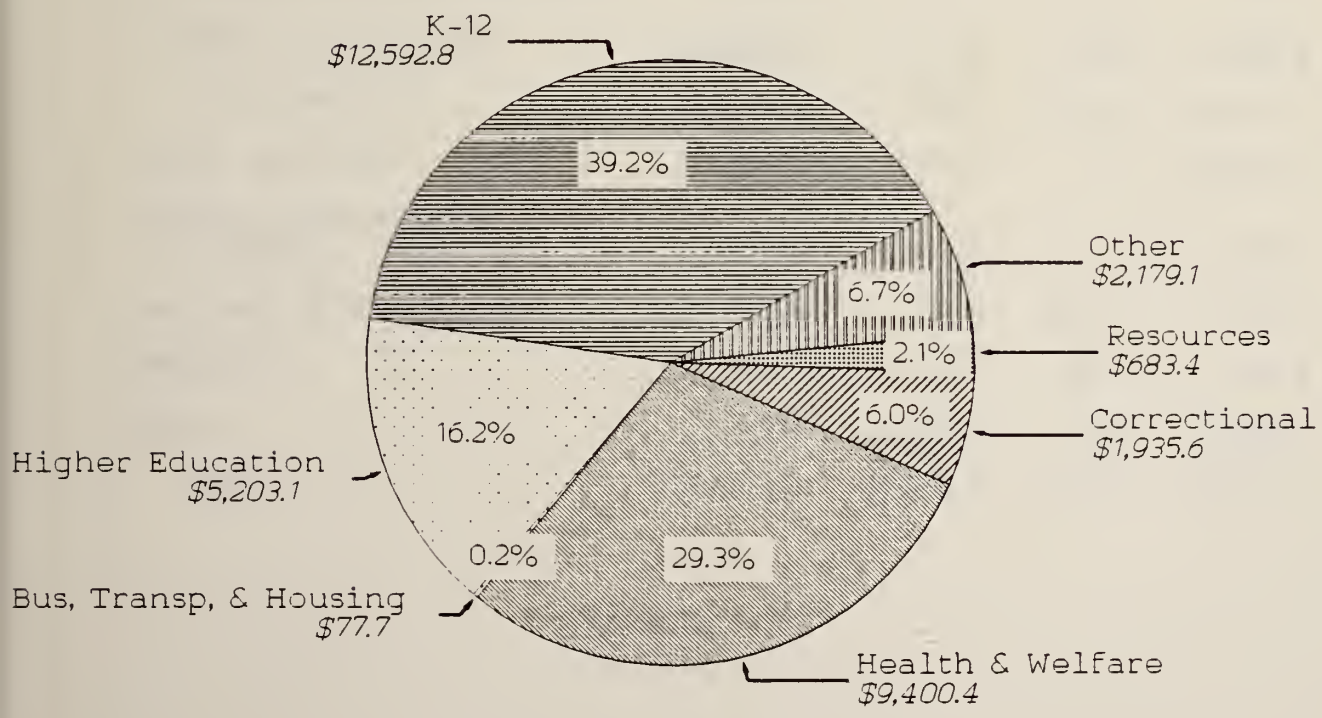
GENERAL FUND REVENUE ESTIMATES
(In millions)

1986-87	Budget Estimate	May Revision	Difference
Source			
Sales Tax	$10,730	$10,890	+$160
Personal Income Tax	12,800	13,980	+1,180
Bank & Corporation Tax	4,315	4,660	+345
Other Revenues and Transfers	2,920	2,932	+12
Total	$30,765	$32,462	+$1,697
1987-88			
Sales Tax	$10,898	$10,583 a/	-$315
Personal Income Tax	13,200	13,710	+510
Bank and Corporation Tax	4,675	4,980	+305
Other Revenues and Transfers	2,969	2,987	+18
Total	$31,742	$32,260	+$518
Total of 1986-87 and 1987-88			+$2,215
Change from 1986-87	+$977	-$202	
Percent	3.2%	-0.6%	

a/ This estimate has been reduced by a $45 million transfer to the TP&D Account and $938 million transfer to local governments (disengagement). The Budget estimate assumed no transfer to the TP&D Account and a $477 million transfer to local governments.

1987-88 EXPENDITURES: GENERAL FUND

(Dollars in Millions)



* %'s do not add to 100% due to rounding.

1987-88 EXPENDITURES
(Dollars in Millions)

Program	General Fund	Special Fund	Bond Funds	Total
Education				
K-12	$12,592.8	$79.5	$400.0	$13,072.3
University of California	1,928.6	3.2	137.4	2,069.2
California State University	1,747.8	--	151.4	1,899.2
California Community Colleges	1,326.6	2.9	63.6	1,393.1
Other Higher Education	200.1	--	0.5	200.6
Total Education	$17,795.9	$85.6	$752.9	$18,634.4
Health and Welfare	$9,400.4	$183.2	--	$9,583.6
Business, Transportation and Housing	77.7	2,414.5	--	2,492.2
Youth and Adult Correctional	1,935.6	27.8	$314.1	2,277.5
Resources	683.4	410.6	495.8	1,589.8
Other	2,179.1	4,076.9	0.5	6,256.5
Total	$32,072.1	$7,198.6	$1,563.3	$40,834.0

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GENERAL FUND EXPENDITURES
(Dollars in Millions)

Program	1986-87	1987-88	Change Dollar	Change Percent
Education				
K-12	$12,120.6	$12,592.8	$472.2	3.9
University of California	1,785.8	1,928.6	142.8	8.0
California State University	1,625.9	1,747.8	121.9	7.5
California Community Colleges	1,233.6	1,326.6	93.0	7.5
Other Higher Education	181.2	200.1	18.9	10.4
Total Education	$16,947.1	$17,795.9	$848.8	5.1
Health and Welfare	$9,556.0	$9,400.4	-$155.6	-1.6
Business, Transportation and Housing	63.0	77.7	14.7	23.3
Youth and Adult Correctional	1,695.0	1,935.6	240.6	14.2
Resources	691.0	683.4	-7.6	-1.1
Other	2,452.2	2,179.1	-273.1	-11.1
Total	$31,404.3	$32,072.1	$667.8	2.1

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EDUCATION EXPENDITURES
TOTAL FUNDS*
(Dollars in Millions)

	1986-87	1987-88	Increase Dollars	Increase Percent
K-12	$15,577	$16,335	$758	4.9
UC	2,102	2,258	156	7.4
CSU	1,626	1,748	122	7.5
CCC	1,848	1,989	141	7.6
Other Education	181	200	19	10.5
Total Education	$21,334	$22,530	$1,196	5.6

* Excludes State Lottery Funds.

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MAY REVISION
GENERAL FUND
EXPENDITURE SUMMARY
(Dollars in Millions)

May 19 Letters

Department	1986-87	1987-88
World Trade Commission	--	$0.1
State Fire Marshal	--	1.0
Alcoholic Beverage Control	--	3.3
Water Resources Control Board	--	7.2
Health Services - Medi-Cal	--	33.9
Health Services	--	7.0
Health Services - Disengagement	--	-443.7
Proposition 65	--	6.7
Developmental Services	--	-0.1
Mental Health	-$6.0	5.9
Social Services	--	42.3
Education (K-12)	--	217.4
State Teachers Retirement System	--	-0.6
University of California	--	40.1
Hastings College of the Law	--	0.1
California State University	--	45.4
California Community College	9.0	99.5
Student Aid Commission	--	0.8
Special Supplemental Subventions	20.8	17.4
Flood Relief -- Reduction in Savings	15.0	--
Commission on State Mandates	--	47.1
Employee Compensation - Civil Service	--	46.2
Statewide-Restore 1% Reduction	--	69.4
Expenditure Legislation	65.6	-36.9
Total May 19	$104.4	$209.5
Previously Acknowledged Deficiencies and Finance Letters	410.1	599.0
TOTAL	$514.5	$808.5

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GENERAL FUND EXPENDITURE DETAIL
1986-87 and 1987-88
(Dollars in Millions)

LEGISLATIVE, EXECUTIVE, JUDICIAL

California State World Trade Commission

	1986-87	--
	1987-88	$0.1

In the budget year, to enhance the export of California products, the Commission proposes to contract to provide marketing services for the London Trade Office. Furthermore, as a result of the devaluation of the dollar, additional funding is requested to maintain trade promotion activities.

STATE AND CONSUMER SERVICES

Office of the State Fire Marshal

	1986-87	--
	1987-88	$1.0

The Governor's Budget proposed to shift $1.3 million from the General Fund to reimbursements in the Office of the State Fire Marshal. The proposal also required legislation to authorize the State Fire Marshal to charge a fee for public building inspections which is similar to fees charged for public building inspections by local fire districts.

After further review of this proposal, it now appears that the State Fire Marshal will be unable to recover all program costs as originally anticipated. The request, therefore, is to shift $1 million from reimbursements back to the General Fund. Expectations are that the remaining $300,000 would be generated from fees which the State Fire Marshal would charge for building inspection services, providing the authorizing legislation is enacted.

BUSINESS, TRANSPORTATION AND HOUSING

Department of Alcoholic Beverage Control

	1986-87	--
	1987-88	$3.3

Over the past several years, the Administration has recognized a growing need to address an increasing number of alcohol related complaints. The 1986-87 and 1987-88 budgets provided some $200,000 for overtime costs to meet workload increases. However, even with additional overtime funds, the average monthly number of complaints has grown from 632 in 1980-81 to 769 in 1985-86, resulting in a complaint backlog of over 3,000 complaints expected at the end of 1986-87. This proposed increase would eliminate this backlog and would help the department to investigate backlocked complaints, prepare accusation and warning letters, make arrests, and prepare for and attend hearings. In addition, this proposal would recognize growing public concerns regarding the significant problems in connection with drinking and driving and automobile accidents among young people.

RESOURCES

State Water Resources Control Board

1986-87	--
1987-88	$7.2

The Governor's Budget proposed a shift to fee recoveries for the State Water Resources Control Board (SWRCB) budget for Water Quality and Water Rights programs to allow for adequate funding of priority programs. However, since that time, estimated General Fund revenues have improved significantly and this reduction is no longer necessary. The Administration is proposing that the reduction be restored. This would result in reduced reimbursements of $7.6 million and increased General Fund expenditures of $7.2 million, for a net expenditure reduction of $400,000.

HEALTH AND WELFARE

Department of Health Services - Medi-Cal

1986-87	--
1987-88	$33.9

For 1987-88, $2 million is proposed to fund Medi-Cal costs associated with providing beneficiary Cost-of-Living Adjustments (COLA) for AFDC recipients (effective July 1, 1987) and SSI/SSP recipients (effective January 1, 1988) consistent with statutory requirements for these programs.

In addition, $12.5 million is proposed to fund increases for contracts with hospitals which serve a disproportionate share of Medi-Cal patients. Disproportionate share hospitals are hospitals which either have an annual patient census of greater than 20.0 percent Medi-Cal, or are county/university hospitals. This augmentation is proposed to cover any rate increases negotiated by the California Medical Assistance Commission during the next three fiscal years.

Finally, $19.4 million is included as an initial estimate of net General Fund costs associated with a long term care rate COLA. This rate is currently under study by the Department of Health Services and the Department of Finance and will not be known precisely until July, 1987. Due to this uncertainty, language is proposed to transfer the appropriate amounts of General Fund savings from the item supporting the Department of Developmental Services to the Department of Mental Health (Item 4440-141-001) to provide a COLA for Institutions for Mental Diseases and the Medi-Cal item to fund the balance of the COLA.

Department of Health Services - AIDS

1986-87	--
1987-88	$7.0

An additional $7 million in General Fund is proposed to augment the existing Acquired Immune Deficiency Syndrome (AIDS) Program within the Department of Health Services. (This will bring the total 1987-88 General Fund budget request for AIDS to $41.1 million and does not include the $3.5 million we are also requesting in Federal Anti-Drug funds for AIDS related issues.) Specifically, this proposal requests: 1) $1,829,000 to meet increased workload in the Alternative Test Site Program. The existing appropriation combined with the May 11, Finance Letter augmentation proposed a total of 8,000 tests per month for 1987-88. This proposal will allow for 11,000 tests per month. This increase is consistent with current workload projections for

Department of Health Services - AIDS (Continued)

the program; 2) $350,000 to restore Information and Education funding at the current year level for emergency service providers and health care professionals; 3) $2.5 million for confidential testing in county clinics and community-based non-profit clinics; 4) $1,196,000 to establish pilot projects to demonstrate alternative approaches to treatment delivery and case management for non-hospital care of AIDS patients with a goal to provide a continuum of care in the most cost effective manner possible; 5) $1 million for increased Information and Education activities focusing on the heterosexual population, at-risk-youth, and minorities; and 6) $125,000 set aside for special projects identified during the year, subject to Legislative notification.

Department of Health Services - Disengagement

1986-87	--
1987-88	-$443.7

A revision to the disengagement proposal contained in the Governor's Budget is proposed to restore the public health categorical programs in the Department of Health Services in the amount of $53 million. In lieu of the categorical programs, the Medically Indigent Services Program (MISP) is proposed to be disengaged. The total amount of local assistance currently budgeted in the MISP program is $498.4 million. This is proposed to be augmented by $12.5 million General Fund to partially restore the funding level of MISP to the 1985-86 level. This increase is reflected in the revenue transfer. An additional $12.5 million General Fund matched with $12.5 million Federal funds is proposed to be added to the Medi-Cal budget for augmentation of contract rates for disproportionate providers of hospital inpatient services. It is expected that a large proportion of these funds would be provided to county hospitals through the California Medical Assistance Commission contracting process. (This proposal is contained in the increases reflected in the Medi-Cal item). Restoration of the positions for the public health categorical programs results in an increased cost of $2.4 million which is partially offset by the staff reduction ($0.7 million) in the Medically Indigent Services program. The total amount of revenue available to the counties under this revised proposal will be $938.3 million.

Proposition 65

1986-87	--
1987-88	$6.7

A total of $11.7 million is proposed to implement the Safe Drinking Water and Toxic Enforcement Act of 1986 in 1987-88. Of this amount, $6.7 million is proposed from the General Fund and $5.0 million is proposed from other funding sources. The departments listed below would incur costs in implementation of the following functions: discharge reporting; scientific-including support of the Scientific Advisory Panel; risk assessments and safe use determinations; technical assistance; monitoring and enforcement; and management and support.

	General Fund Dollars in Thousands
Secretary for Health and Welfare	$465
State Air Resources Board	70
Department of Fish and Game	23
Department of Food and Agriculture	2,099
Department of Health Services	2,081
Office of Emergency Services	23
State Water Resources Control Board	1,935
Total	$6,696

Department of Developmental Services — 1986-87 --; 1987-88 -$0.1

This estimate reflects a proposed net reduction of $147,000. This proposed reduction is attributable to (1) a savings of $722,000 to reflect the impact of using a 2.6 percent Supplemental Security Income/State Supplementary Program (SSI/SSP) Cost-of-Living Adjustment (COLA) effective January 1, 1988 and (2) an increase of $575,000 to correct a technical error in the Regional Center estimate proposed in our May 11, 1987 expenditure letter.

The SSI/SSP action would conform to the proposal to provide a six month COLA to address statutory requirements as reflected in the Department of Social Services' budget.

Department of Mental Health (DMH) — 1986-87 -$6.0; 1987-88 5.9

In the current year, the DMH anticipates a $6.0 million savings in its Residential Care Services Program. These savings are proposed to be reappropriated to provide partial funding for a $9.5 million augmentation to fund an increased level of mental health services to special education pupils pursuant to Chapter 1747, Statutes of 1984 and Chapter 1274, Statutes of 1985.

In addition, this revision proposes a $3.5 million reduction to reflect the reduced caseload projections for the Mentally Disordered Offender (MDO) inpatient and outpatient populations. The year-end MDO inpatient caseload is estimated at 102 patients and the year-end outpatient caseload is 54 patients. These MDO savings are proposed for redirection to fund the balance of the $9.5 million increase for special education pupils.

This revision also proposes a conforming action associated with the proposal to provide a 2.6 percent SSI/SSP COLA effective January 1, 1988. The May 11, May Revision expenditure letter included a proposal to allow DMH to assume the payment delivery system for mentally disordered patients in skilled nursing facilities with special treatment programs. Since a large portion of these patients are SSI/SSP eligible, the SSI/SSP COLA would offset $104,000 in General Fund costs currently proposed for this program.

Department of Social Services (DSS) — 1986-87 --; 1987-88 $42.3

The 1987-88 Governor's Budget included $76.3 million General Fund to support half year funding for statutory required cost-of-living adjustments (COLA's) to various programs within the DSS. The proposed increase of $42.3 million would provide full year funding for statutory COLAs. This proposed adjustment also reflects the change in the California Necessities Index (3.6 percent to 2.6 percent) which is used to estimate statutory COLAs. The proposed increased COLA includes funds for the Aid-to-Families with Dependent Children ($16.5 million), Supplemental Security Income/ State Supplementary Program ($25.7 million) and In-Home Supportive Services programs ($0.1 million).

EDUCATION

Department of Education (K-12)

1986-87	--
1987-88	$217.4

For 1987-88, the May 11 portion of the May Revision reflected increased expenditures of $117.9 million. The May 19 Revision proposes increased expenditures of $215.4 million. This proposal reflects increased expenditures for statutory cost-of-living adjustments (COLAs) ($209.1 million) and Small School District Transportation ($10.0 million). These increases would be offset by an adjustment to special education entitlements (-$3.7 million).

The 1987-88 Governor's Budget provides $158.8 million for K-12 statutory COLAs, effective January 1, 1988. The Administration proposes to increase funding for K-12 COLAs from $158.8 million to $367.9 million, or by $209.1 million. This proposed augmentation would fund full-year K-12 statutory COLAs based on current COLA indices, including providing a 2.5 percent COLA for programs using the State and Local Government Goods and Services Index. In addition, the proposed augmentation will fund COLAs for Desegregation and Gifted and Talented Education programs, for which no COLAs were provided in the Governor's Budget.

It is estimated that expenditures for special education will decrease by $3.7 million due to the effect of the full statutory COLAs in revenue limits. Because revenue limits for special day classes are considered to be an offset against General Fund expenditures in special education, an increase in revenue limits results in a reduced level of General Fund need in special education.

The 1987-88 Governor's Budget provides $10 million in half-year funding for the Small School District Transportation Program. It is proposed to fully fund the program in the budget year, for an augmentation of $10 million.

In our May 11, 1987 letter, we advised that estimated expenditures for the Greater Avenues for Independence (GAIN) Program would be reduced by $11.8 million during 1986-87. Of that amount, $2 million represented the reappropriation of adult education funds in the 1985 Budget Act made by Chapter 1025, Statutes of 1985. It is now estimated that these funds, which are available until June 30, 1988, will be expended for GAIN-related K-12 education during 1987-88.

Current State law mandates educational services to all handicapped children over the age of 5, and to those children aged 3 and 4 with the most intensive needs. In 1986-87, California is providing such services to approximately 24,000 children in the 3-5 age group, at an estimated cost of $92 million ($84 million General Fund).

P.L. 99-457 was enacted by Congress and the President in October 1986. This law amends the Education for the Handicapped Act (P.L. 94-142) by authorizing two new discretionary federal grant programs -- one relating to services for handicapped infants and one relating to services for handicapped toddlers or pre-school children -- that will take effect July 1, 1987. It is the intent of the Administration to fully participate in the pre-school portion of this new program.

By participating in this new program, California will begin serving preschool children with less severe handicaps. These children can most benefit from

Department of Education (K-12) (Continued)

early special education programs, and in many cases will be served in regular education by the time they reach first grade. It is estimated that the federal grant to California will be approximately $25 million in 1987-88. This will allow us to serve an additional 6,000-8,000 children in 1987-88. The Administration will work closely with the Legislature, the Superintendent of Public Instruction, and the Special Education community to establish the most effective program.

Contributions to the State Teachers' Retirement System		
	1986-87	--
	1987-88	-$0.6

The Governor's Budget included $9.0 million for a cost-of-living adjustment for Contributions to the State Teachers' Retirement Fund as required under the provisions of Chapter 282, Statutes of 1978 (AB 8). Contributions are annually adjusted to reflect the June-to-June change in the composite California Consumer Price Index (CCPI) in the San Francisco and Los Angeles areas for the preceding year. The COLA amount reflected in the Governor's Budget was based on the estimate of CCPI at the time, 3.85 percent. Revised estimates by the Department of Finance place the CCPI factor at 3.4 percent. The COLA, which is appropriated by Education Code Section 23401, is now estimated at $8.4 million for a proposed reduction in the expenditure estimate of $585,000.

University of California		
	1986-87	--
	1987-88	$40.1

In January, the Governor's Budget included $12.3 million to provide a 3 percent increase for UC faculty effective January 1, 1988. The Administration is proposing an increase to that amount of $11.1 million to fund an additional 2.7 percent faculty salary increase effective January 1, 1988. This total of $23.4 million represents the 2.1 percent increase recommended by CPEC in its survey of eight comparison institutions plus the 3.6 percent differential or competitive edge over the comparison institutions provided in the budget for the last three fiscal years.

The Governor's Budget included $9 million to provide a 3 percent salary increase for non-academic staff effective January 1, 1988. In order to conform to the salary increase being provided to State civil servants, this amount is requested to be increased by $9 million to cover a 3 percent increase for a full year.

As a result of adjustments in the health and dental benefits rates for State civil service employees, a $1.1 million increase over the $5.4 million budgeted amount for UC employee health and dental benefits is proposed. Under this proposal, employee health and dental benefits would total $6.5 million.

To preserve the commitment to provide students with an education that allows them to be more competitive in the job market, the Administration is proposing $7.5 million to the budget for computing equipment. These funds would allow UC to continue increasing student access to computing equipment.

University of California (Continued)

To ensure continued and timely statewide access to UC's vast library resources, it is requested that an additional $1.4 million be budgeted to begin to replace obsolete computer equipment for the MELVYL system. MELVYL is UC's on-line computerized catalog of its statewide library holdings.

While current funding for deferred maintenance and special repairs at UC amounts to $17.7 million, the need exceeds the present budget. The Administration is proposing an additional $10 million in 1987-88 to continue its multi-year commitment to address UC's needs in this area.

Hastings College of the Law	1986-87	--
	1987-88	$0.1

Consistent with the employee compensation increases proposed for University of California employees and State civil servants, the May 19 Revision proposes the following increases to the Governor's Budget:

- $73,000 to provide a 5.7 percent salary increase for faculty, effective January 1, 1988.
- $69,000 to provide a 3 percent salary increase for non-faculty employees, effective July 1, 1987.
- $6,000 to provide health and dental benefits comparable to those proposed for State civil servants.

California State University (CSU)	1986-87	--
	1987-88	$45.4

Requested revisions to the Governor's proposed budget for Fiscal Year 1987-88 total $45.4 million. These proposed increases would enable CSU to provide equitable faculty and non-faculty salary increases and further enhance the instructional quality of CSU programs.

Highlights of the proposed changes include:

- $15.2 million for a 6.9 percent faculty salary increase effective January 1, 1988.
- $8.2 million for a 3 percent non-faculty salary increase effective July 1, 1987.
- $7.0 million to enable CSU to purchase additional student EDP computer workstations and equipment.
- $5.2 million to fully fund the Instructional Equipment Replacement Depreciation model.
- $5.0 million to continue the Administration's multi-year commitment to address CSU's maintenance and special repair needs.
- $1.7 million to fund three additional On-Line Public Access (OLPAC) systems that have a pay back period of six years.

California State University (CSU) (Continued)

- $1.3 million to allow the installation of two additional centrex replacement systems.
- $0.8 million to fund the higher PERS employer contributions for health and dental benefits.
- $0.5 million to provide assessment and additional support services to learning disabled students.
- $0.3 million to fund a comprehensive evaluation of child care needs throughout the CSU.
- $0.2 million to enable CSU to begin planning for the permanent off-campus center in North San Diego County projected to open in 1991-92.

Community Colleges		
	1986-87	$9.0
	1987-88	99.5

Proposed expenditures in the Community Colleges (CC) would increase the 1987-88 proposed budget by $99.5 million. These proposed increases are composed of changes in apportionments, matriculation, instructional equipment, deferred maintenance, management information system and the Puente Project.

Current Year

As reported in a Finance Letter submitted on February 24, 1987, expenditures for apportionments have increased by $9 million, due to the allocation of funds for Equalization. The Governor's Budget assumed that the equalization funds would not be allocated in 1986-87.

Budget Year

Highlights of the proposed increases are:

- $40.3 million for general apportionments, to provide a full-year statutory cost-of-living adjustment of 3.4 percent.
- $21 million as a special apportionment for growth in basic skills courses, e.g., remedial English and math, English-as-a-second language.
- $19 million as a base adjustment for additional growth, to meet the demand for courses other than basic skills courses.
- $8.9 million for instructional equipment replacement and library materials. $3.9 million of this is to replace the reappropriated funds from the current year that was proposed in the Governor's Budget but reduced in the May 11 Finance Letter because the current year apportionment savings did not materialize as estimated.
- $6.9 million for the initial purchase of data processing equipment and systems development for matriculation, including the elimination of the proposed district matching requirement.

Community Colleges (Continued)

- o $2.3 million for deferred maintenance.
- o $0.9 million for a management information system pilot project.
- o $0.2 million for the Puente Project.

Student Aid Commission (SAC)	1986-87	--
	1987-88	$0.8

The Governor's Budget for 1987-88 did not provide for an increase in the maximum grants for student financial aid. The SAC has submitted an updated request to raise the maximum amounts payable for grants to recognize current tuition costs.

This request proposes to allocate $700,000 to increase the maximum limit for Cal Grant A awards ($50) to $4,370 from the current $4,320 and to allocate $100,000 to increase the maximum limit for Cal Grant B awards ($60) to $5,460 from the current $5,400 (including both tuition costs and subsistence).

STATEWIDE

Special Supplemental Subventions (Redevelopment Agencies)	1986-87	$20.8
	1987-88	17.4

Expenditures required under Section 16111 of the Government Code were estimated in the proposed Governor's Budget as being reduced by pending legislation. The Administration subsequently supported legislation (SB 662 and AB 1013) which would have limited subventions to redevelopment agencies. However, the Legislature has rejected the proposal to reduce these subventions. Therefore, General Fund expenditures under Government Code Section 16111 will be greater than previously estimated by $20.8 million in 1986-87 and $17.4 million in 1987-88.

Flood Relief -- Reduction in Savings	1986-87	$15.0
	1987-88	--

Final claims for flood relief funds appropriated by Chapter 16/86 have been higher than anticipated. Review of some claims is still in progress and there is still some uncertainty as to the amount needed to match Federal assistance in the San Joaquin Delta. However, at this time we estimate that anticipated savings from funds appropriated in Chapters 16 and 1110 of 1986 will be $15 million less than anticipated.

Commission on State Mandates	1986-87	--
	1987-88	$47.1

The Governor's Budget and implementing legislation (SB 1313, Seymour) proposed to: (1) repeal twenty-nine mandates; (2) make fifteen mandates optional; (3) retain five mandates but fund them from sources other than General Fund; and (4) exempt local government from one mandate. Instead, it is now requested that funding for forty-seven of these fifty mandates proposed for

Commission on State Mandates (Continued)

modification now be restored, resulting in an augmentation of $47.1 million. The three mandates which would remain unrestored under this proposal are local government unemployment insurance costs ($25.9 million), collective bargaining in schools ($12.1 million), and local hospital fees to the Office of Statewide Health Planning and Development ($325,000).

Augmentation for Employee Compensation		
	1986-87	--
	1987-88	$46.2

The Governor's Budget contains funding for a three percent general compensation increase, effective January 1, 1988, subject to collective bargaining, as applicable. The Governor's Budget as proposed also funds health and dental benefit rate increases for active and retired Civil Service employees. The proposed change reflects the funding necessary to permit a full year three percent general compensation increase and to fund the net increases in health and dental rates based on more recent data. In addition to the General Fund amount of $46.2 million, Special Funds are proposed to increase by $24.4 million and Non-governmental Funds by $16.2 million.

Restoration of 1 Percent General Fund Reduction		
	1986-87	--
	1987-88	$69.4

During preparation of the proposed Governor's Budget, estimated General Fund revenues were insufficient to fund priority programs. It was necessary, therefore, to implement a 1 percent General Fund reduction of the budgets of various agencies to allow for adequate funding of priority programs. Since that time estimated General Fund revenues have improved significantly and this reduction is no longer necessary. The Administration is proposing that it be restored.

May Revision Legislation

1986-87 Expenditure Legislation		
	1986-87	$65.6
	1987-88	-36.9

The 1986-87 budget was enacted with the understanding that the Legislature would pass legislation which would redirect $300 million in surplus funds from the Public Employees' Retirement System (PERS) to the General Fund. Such legislation was not enacted and the Governor vetoed funding for various programs. Subsequently, Chapters 891/86 and 1467/86 were signed to provide $43.3 million (one-half year funding) for the Urban Impact Aid and Meade Aid programs, $10 million for Small School District Transportation, and $6.2 million for declining ADA in community college districts. The Administration agreed to provide the remaining $71.5 million when legislation transferring the surplus PERS funds was enacted.

Because such legislation has not been enacted, the Administration will support legislation to redirect $42.8 million in existing resources and provide a General Fund augmentation of $28.7 million, $25.0 million of which is proposed to be transferred to the General Fund from SAFCO, to fully fund these programs in the current year and to fund declining ADA in community college districts.

1986-87

In the 1987-88 Governor's Budget, the 1986-87 State Appropriation Limit was estimated to be $24,159 million and appropriations subject to the limit were estimated to be $23,738 million, or $421 million under the limit.

Since that time we have reviewed a number of issues regarding the State Appropriation Limit raised by the Legislative Analyst and have recognized corrections which increase the limit by approximately $177 million. These changes concern our previous treatment of certain non-tax revenues and their impact on the Limit and a State Appropriation Limit correction for Community College local revenues that was made at 1978-79 dollar values instead of 1986-87 values. Based on these changes, we currently estimate the limit on appropriations to be $24,336 million for the 1986-87 fiscal year, assuming no shifts in financial responsibility or shifts to or from user fees take place during the remainder of the fiscal year.

Regarding appropriations subject to the limit, Chapter 1205, Statutes of 1980, provided that approximately 60 percent of State aid to school districts would count against the State's limit and that the remaining 40 percent would count against local school district limits. This division was intended to maximize the growth of the State's appropriation limit and to equalize the amount of unused appropriations capacity at the local level. Because of unforeseen circumstances, however, it now appears that local school districts, rather than the State, have a sizable amount of unused appropriations capacity. This change would require legislation and while it could reduce the State's appropriations subject to the limit by as much as $400 million, we believe it is totally consistent with the intent of Proposition 4 and the language of the Constitution.

In addition, when we computed the appropriations subject to the limit in the Governor's Budget we erroneously deducted a subvention of $51 million to Community College districts from the State's appropriations subject to the limit. These subvention funds have been included in the computation of the State's appropriations subject to the limit.

As shown on the previous documents, estimated General Fund revenues for the 1986-87 fiscal year have increased by $1,698 million since the January estimate. Adjusting expenditures for desegregation costs and for reduced debt service on General Obligation bonds, both of which are not subject to the limit, we estimate that $998 million can be spent within the appropriations limit and $700 million must be returned to the taxpayer. This budget revision proposes to appropriate $490 million of the available revenues to the Reserve for Economic Uncertainties and the remainder, $508 million to various programs.

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1987-88

In the 1987-88 Governor's Budget, the 1987-88 State Appropriation Limit was estimated to be $25,273 million and appropriations subject to the limit were estimated to be $25,193 million, or $80 million under the limit.

We now have actual figures for the Consumer Price Index adjustment to the limit and revised population figures from the Bureau of the Census plus revisions to the limit as a result of shifts from school districts and other state programs. These changes result in a change in the factor from 4.6 percent to 5.42 percent, which results in an increase to the limit of a net of $195 million.

As a result of the non-tax revenue adjustments and Community College local revenue adjustments implemented in the current year (1986-87), the Administration's concurrence on changing the K-12 local school district limit calculation on subvention funds, and the limit increase as a result of cost of living and population factors, we estimate the State Appropriation Limit to be $25,634 million in 1987-88.

As shown on the previous documents, General Fund revenues for the 1987-88 fiscal year are up $518 million. Adjusting appropriations subject to the limit for increased special fund revenues that are subject to the limit, we estimate that $348 million can be spent within the appropriation limit and $170 million is in excess of the limit. However, revenue estimates are based on long-range assumptions. If we do end the year over the limit then these monies would also be returned to the taxpayer.